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SUBJECT: GEORGIA BI-WEEKLY UPDATE AUGUST 17

¶1. This cable contains current items of political, economic, and social interest concerning Georgia during the weeks of August 4-17.

Saakashvili Visits Upper Abkhazia

¶2. On August 11, President Saakashvili visited the Upper Kodori Gorge (or Upper Abkhazia) for what he described as several days vacation. He toured a new Patriot youth camp and gave an interview to CNN while there. Addressing the campers, Saakashvili stressed that restoration of Georgia's jurisdiction in Kodori and nearby areas was carried out not through violence and confrontation, but through construction of hospitals, roads, movie theaters and disco clubs. He said "Our peace policy is, yes, you may call it, a policy of discos. This is a policy of youth camps, this is a policy of theaters, this is a policy of civilization, education and enlightenment which denounces the logic of violence and weapons...If they bomb us here, we will respond by building new discos, new hospitals and schools." Saakashvili told CNN that there can be no purely military solution to Georgia's separatist conflicts, adding that "We have just sent our best brigade to Iraq. That is not done by countries that are looking forward to a military confrontation."

Georgia Complains about Russian Medals for South Ossetians

¶3. Georgian officials have responded angrily to a decree by Russian President Putin, posted on the Kremlin website August 14, to award Russian state medals to 12 residents of breakaway South Ossetia for a meritorious service in the education sphere. One recipient of the "Honored Teacher of the Russian Federation" award was de facto education minister Ella Jioeva, identified in the decree as "Minister of Education of the Republic of South Ossetia." Georgian State Minister for Conflict Resolution David Bakradze described the award, given without Georgia's consent, and the use of the phrase "Republic of South Ossetia" for the unrecognized regime as violations of international legal principles. Georgia demanded an explanation in a protest note delivered to the Russian Ambassador.

Negotiations Underway for Iranian Gas

¶4. KazTransGaz-Tbilisi, a Tbilisi gas distribution company owned by the Kazakh state-owned company KazTransGaz, has announced it is negotiating with Iran, as well as with Russia and Azerbaijan, about gas supplies for the coming winter. The company's director told a news conference that the high price of Russian gas had prompted the search for alternative suppliers, although he added that this did not rule out Russian gas. Russia increased the price from USD 110 to USD 235 per 1,000 cubic meters of gas at the beginning of **¶2007**. In 2006, the main gas supplier to Georgia was Gazexport, a subsidiary of Gazprom. It supplied 1.2 billion

cubic meters, of which almost half was used by the Tbilisi gas distributing company. Reportedly, Russia has negotiated gas prices for the coming year with all of its partners except Georgian consumers. Georgia allows gas consumers to negotiate their own deals with Gazprom and other suppliers.

Growing Interest in Georgia's Banking Sector

¶ 15. The National Bank of Georgia (NBG) has issued HSBC, one of the world's largest banks, a license to start banking operations in the country. HSBC's Tbilisi branch is slated to start serving its first customers in November. HSBC is the second major Western bank to enter the Georgian market after Societe Generale, which bought Bank Republic in 2006. NBG president Roman Gotsiridze said after meeting with HSBC officials on July 30 that the London-based banking group's entry into Georgia is evidence of growing interest from investors around the world in the country. HSBC Bank's Georgia director, Steven Bennett, publicly praised Georgia's structural reforms as well as the improvement of the business environment in Georgia. Tbilisi expects that the domestic banking sector will attract USD 700 million in foreign investment by the end of the year, predicting that even more foreign banks will step into the market before long.

Bank of Georgia Acquires Cascade Bank

¶ 16. The Bank of Georgia (BOG), Georgia's largest commercial bank, has announced it will acquire the American-owned Cascade Bank of Georgia. BOG intends to change its name to Galt & Taggart Bank by October. Cascade Capital Holdings, owned by the U.S.-based Cafesjian Family Foundation, purchased Cascade Bank in January 2006, when it was known as Emporiki Bank. Separately, a wholly owned subsidiary of the BOG, Georgian Leasing Company (GLC), recently received a loan of USD 7.5 million from an OPIC-backed company, Worldwide Business Capital. The loan is

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designed to finance small and medium leasing operations. Presently GLC has 35 percent of the leasing market in Georgia. About 23 percent in BOG is owned by U.S. shareholders, including the New York-based Firebird Fund. BOG is the first, and so far, the only Georgian bank to issue stock on the London Stock Exchange.

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